Financial regulation: 2000 Q3

1. INTRODUCTION

Few financial provisions were issued in the third quarter of the year.

First, the European Central Bank (ECB) has made a number of arrendments to the minimum reserves system in order to facilitate the liquidity management of the ECB. Procedures have been established for confirming reserve requirements (1) and for determining the obligations of institutions affected by mergers and divisions. As a consequence of these reforms, parallel changes have been made to the regulation concerning the consolidated balance sheet of the monetary financial institutions sector.

The Council of the European Union, meanwhile, has published a framework Decision to increase protection against counterfeiting of the euro by criminal penalties and other sanctions. This decision supplements the existing provisions in this area and compliance by the Member States with its provisions is mandatory.

In relation to credit institutions, the accounting treatment for the coverage of the pension commitments of credit institutions has been adapted to the provisions of the Regulation on the application of firms' pension commitments to employees and beneficiaries.

In the securities-market area, the rules on the notification of significant holdings in listed firms and the acquisition by the latter of own shares have been updated to incorporate new notification obligations for the directors and managers of listed firms. The latter must notify any acquisitions and disposals by them of stock options on their company's shares, and their systems of compensation, and the official formats for such notifications have been established. At the same time, the accounting standards and formats for the supervisory and public financial statements of venture capital entities and their management companies have been established.

Finally, in relation to money laundering, the reporting obligations of financial institutions have been extended to include transactions with certain countries and territories that are not co-operating in the fight against money laundering.

(1) These are balances which those institutions subject to the minimum reserves system must hold at their respective NCB (eligible assets) having deducted the allowance of EUR 100,000.

2. EUROPEAN CENTRAL BANK: AMENDMENT OF MINIMUM RESERVES

The Statute of the ESCB and of the ECB authorises the latter to define a minimum reserves requirement, also known as the minimum reserve ratio, which has been obligatory for Member States' credit institutions since January 1999. The ECB submitted Recommendation 98/C246/06 of 7 July 1998 on the application of minimum reserves to the Council of the European Union so that this body might publish the related provisions, which it did through Council Regulation (EC) 2531/98 of 23 November 1998 (2). This regulation established the general principles and basic aspects of and the limits to the requirement, which were subsequently implemented by ECB Regulation 2818/1998 of 1 December 1998 (3) on the application of minimum reserves, for their entry into force on 1 January 1999, coinciding with the start of Stage Three of Economic and Monetary Union.

Recently, the ECB has published *Regulation 1921/2000 of 31 August 2000* (OJ of 9 September 2000) amending Regulation 2818/1998 in order to make a number of changes to the minimum reserves system, although they do not affect the reporting formats, procedures or periodicity of MU statistical returns sent to the Banco de España. Consequently, the related provisions in Banco de España Circular 4/1991 of 14 June 1991 (4), which detail the accounting rules and financial statement formats for credit institutions, remain applicable.

The main change in this Regulation is the introduction of the procedure for confirming eligible liabilities, which will be determined by each national central bank (NCB) in accordance with the principles laid down in the aforementioned Regulation. To date, the NCBs accepted changes in eligible assets and liabilities without a specific date, while under this Regulation the deadline for alterations and changes therein is regulated. Nonetheless, besides the deadlines contained in the Regulation, the NCBs may publish specific timetables detailing the periods established for notification, confirmation, revision or acceptance of the data relating to the reserves required (5).

In the cases of *mergers* (6) and *divisions* (7) affecting credit institutions, specific procedures are determined in order to clarify the obligations they face in respect of reserve requirements. In the case of mergers, the acquiring institution shall assume the reserve requirements of the merging institutions and it shall be entitled to deduct the allowance of EUR 100,000 that would have been granted to the merging institutions. The amount of the merging institutions' reserves during the maintenance period in which the merger takes place shall count towards compliance by the acquiring institution with reserve requirements. As to the maintenance period following the merger, the reserve requirement of the acquiring institution shall be calculated on the basis of a reserve base aggregating the sum of the bases of the merging institutions and, if applicable, of the acquiring institution.

The case of divisions is similar: i.e. the receiving institutions shall respectively assume the reserve requirement of the institution being divided. During the maintenance period in which the division takes place, each receiving institution (which is a credit institution) shall be liable in proportion to the part allocated to it of the reserve base of the institution being divided. It shall also be entitled to the allowance of EUR 100,000 that would have been granted to the institution being divided. For the following maintenance period, and thereafter, each receiving institution which is a credit institution shall, in addition to its own reserve requirement, assume that reserve requirement calculated on the basis of the part of the reserve base allocated to it of the institution being divided.

3. EUROPEAN CENTRAL BANK: CHANGES TO THE STATISTICAL INFORMATION AND CONSOLIDATED BALANCE SHEET

In step with the amendments to the minimum reserve ratio, aforementioned *Regulation 1921/2000 of 31 August 2000* also amends Regulation 2819/98 of the ECB of 1 December 1998 (8) concerning the consolidated balance

(2) See «Financial regulation: fourth quarter of 1998» in *Economic bulletin,* Banco de España, January 1999, pp. 76-77.

(3) See preceding note.

(4) See «Regulación financiera: segundo trimestre de 1991», in *Boletín económico,* Banco de España, July-August 1991, pp. 58-60.

(5) The Banco de España has established a timetable setting down the deadlines for confirmation of eligible liabilities in a letter dated 3 October addressed to the financial institutions concerned.

(6) A merger is an operation whereby two or more credit institutions (the merging institutions), on being dissolved without going into liquidation, transfer all their assets and liabilities to another credit institution (the acquiring institution), which may be a newly established credit institution.

(7) A division is an operation whereby a credit institution (the institution being divided), on being dissolved without going into liquidation, transfers all its assets and liabilities to other institutions (the recipient institutions), which may be newly established credit institutions.

(8) See «Financial regulation: fourth quarter 1998» in *Economic bulletin,* Banco de España, January 1999, p.78.

sheet of the monetary financial institutions sector.

Thus, in respect of statistical reporting obligations and in the event of mergers or divisions, the credit institutions concerned shall inform the appropriate NCB of the procedures envisaged to comply with the statistical reporting obligations laid down in Regulation 2819/1998.

Finally, and in accordance with the foregoing, the use of statistical information on the application of minimum reserves is extended. As a result, credit institutions subject to the minimum reserve ratio shall be able to communicate any revision of the reserve base and of the reserve requirement in accordance with the procedures laid down by the relevant NCB.

4. CREDIT INSTITUTIONS: CHANGES TO ACCOUNTING STANDARDS

Law 30/1995 of 8 November 1995 (9) on the regulation and supervision of private insurance crafted the regime governing the application of companies' pension commitments to employees, retirees and beneficiaries (the so-called *externalisation regime),* including the benefits occasioned. At the same time, it amended Law 8/1987 of 8 June 1987 (10) on the regulation of pension schemes and funds along these lines. Subsequently, this regime was implemented by means of Royal Decree 1588/1999 of 15 October 1999, which approved the Regulation on the application of firms' pension commitments to employees and beneficiaries (also known as the externalisation regime). This regulated the way in which such commitments may be covered, their valuation criteria and the rules governing any deficits that may exist upon the entry into force of this decree.

Meanwhile, Banco de España Circular 4/1991 of 14 June 1991 (11) setting out the accounting rules and financial statement formats for credit institutions has frequently been amended to incorporate the changes which have affected the credit system. *Banco de España Circular 5/2000, of 19 September 2000* (BOE of 26 September 2000) has recently adapted the accounting treatment for the coverage of the pension commitments of credit institutions to the provisions of Royal Decree 1588/1999.

The Circular addresses pension commitments and risks, distinguishing between the accounting treatment of accrued pension commitments and risks covered by non-autonomous funds and of those covered by autonomous funds, in accordance with the rules laid down in the above-mentioned Regulation.

As regards *non-autonomous funds,* accrued pension commitments and risks shall be valued and covered applying objective criteria, at least as strict as those established by Royal Decree 1588/1999. When fixing the hypotheses not regulated in the Regulation the criteria that may have been contractually agreed with the beneficiaries, if any, shall be applied; in all other cases, until a provision contemplating them is published, prudent and mutually consistent criteria shall be applied. In any case, the following are established:

— The technical interest rate may not exceed by more than two percentage points the growth rate of wages.

— The growth rate of wages shall be at least one percentage point higher than the rate of growth of Social Security pensions.

— If the entity's commitments include annual revaluation of pension supplements, the technical interest rate may not exceed by more than three percentage points the pension revaluation rate.

— The estimated age of retirement of each employee shall be the earliest at which they are entitled to retire, and no reductions shall be envisaged for staff turnover.

The Circular then specifies the way in which these commitments shall be reflected in the supervisory statements, providing for the case in which the entity, in whole or part, covers its risks arising from non-autonomous funds with insurance contracts under which the entity continues to assume the actuarial risk or the investment risk, or both.

As regards *autonomous funds,* reference is made to the accrued pension commitments and risks covered with insurance contracts, pension schemes or both in accordance with the provisions of the Regulation. These commitments shall not be reflected in the memorandum accounts of the supervisory balance sheets. Also, the amounts that must be contributed periodically to insurance companies or pension

(9) See "Regulación financiera: cuarto trimestre de 1995", in *Boletín económico,* Banco de España, January 1996, pp. 86-91.

(10) See "Regulación financiera: segundo trimestre de 1987", in *Boletín económico,* Banco de España, July-August 1987, pp. 49-51.

(11) See «Regulación financiera: segundo trimestre de 1991», in *Boletín económico,* Banco de España, July-August 1991, pp. 58-60.

schemes for the accrual of pension rights shall be allocated to the profit and loss account as contributions to autonomous pension funds.

In relation to the accrued pension commitments and risks with respect to beneficiaries unaffected by Royal Decree 1588/1999, when they are covered with contributions to insurance companies or pension schemes in which the entity does not retain any insurable actuarial risk or any investment risk, they shall be treated as autonomous pension funds. When the entity does retain actuarial risk or investment risk or both, they shall be treated as non-autonomous pension funds. These accrued pension commitments and risks shall be valued by applying objective criteria best adapted to the circumstances and characteristics of the groups of beneficiaries concerned. In all cases, prudent and mutually consistent criteria that ensure the entity's solvency shall be applied.

In all these cases, the entities shall send to the Banco de España, before 31 March each year, an actuarial report on the pension commitments and risks covered with non-autonomous funds and with autonomous funds and on other accrued pension commitments and risks, all as at 31 December of the previous year.

The Circular also provides for the commitments assumed with early-retired staff, i.e. staff that have ceased to provide services to the entity but who, without having legally retired, continue to enjoy economic rights vis-à-vis the entity until they are legally retired, as well as staff compensation in respect of seniority bonuses or the like that is not yet due.

Finally, the Circular takes the opportunity to supplement the information on securities issued by credit institutions (responding to a request by the ECB), and to adapt the definition of non-profit institutions serving households to that established in Regulation 2223/96/EC on the European System of National Accounts.

5. INTRODUCTION OF THE EURO: PROTECTION BY CRIMINAL PENALTIES AND OTHER SANCTIONS AGAINST CURRENCY COUNTERFEITING.

Council Regulation (EC) 974/98 of 3 May 1998 on the introduction of the euro lays down that currency denominated in euro shall start to be put into circulation as from 1 January 2002 and obliges the participating Member States to ensure adequate sanctions against counterfeiting and falsification of euro banknotes and coins. Subsequently, various recommendations of Community bodies have been orientated at the adoption of measures to protect banknotes and coins denominated in euro and to fight counterfeiting of the currency.

Recently, the Council of the European Union has published a *framework Decision of 29 May 2000* (OJ of 14 June 2000) on increasing protection by criminal penalties and other sanctions against counterfeiting in connection with the introduction of the euro, in order to supplement the existing provisions in this area and to facilitate their application by the Member States.

In this respect, each Member State shall take the necessary measures to ensure that the following conduct is punishable:

— Any fraudulent making or altering of currency, whatever means are employed.

— The import, export, transport, receiving, or obtaining of counterfeit currency with a view to uttering the same and with knowledge that it is counterfeit.

— The making or possession of instruments, articles, computer programs and any other means peculiarly adapted for the counterfeiting or altering of currency, as well as of holograms or other components of currency which serve to protect against counterfeiting.

— The use of legal facilities or materials to manufacture banknotes or coins, without the agreement of the competent authorities.

— The fraudulent uttering of counterfeit currency.

Also, each Member State shall take the necessary measures to ensure that the conduct referred to be punishable by effective, proportionate and dissuasive criminal penalties, including penalties involving deprivation of liberty which can give rise to extradition.

As regards legal persons, each Member State shall take the necessary measures to ensure that they can also be held liable for the above-mentioned offences when committed for their benefit by any person, acting either individually or as part of an organ of the legal person, who has a leading position within the legal person, or when lack of supervision or control has rendered possible the commission of such an offence by a person under the authority of the legal person. As regards the sanctions for legal persons, they shall be effective, proportionate and dissuasive sanctions, which shall include

criminal or non-criminal fines and may include other sanctions such as: exclusion from entitlement to public benefits or aid; temporary or permanent disqualification from the practice of commercial activities; placing under judicial supervision; or a judicial winding-up order.

Finally, Member States shall take the necessary measures to comply with this framework Decision by 31 December 2000, as far as offences relating to the future banknotes and coins of the euro committed before 1 January 2002 are concerned, and not later than 29 May 2001, as far as the other provisions are concerned.

6. SECURITIES MARKET: NOTIFICATION OF THE STOCK OPTIONS AND SYSTEMS OF COMPENSATION OF THE DIRECTORS AND MANAGERS OF LISTED COMPANIES

Law 55/1999 of 29 December 1999 on fiscal, administrative and social measures amended Securities Market Law 24/1988 of 28 July 1988 (12), extending the rules on notification and publication to cover the acquisition and disposal by company directors of any kind of stock option over their company's shares. Law 55/1999 also expressly established a duty to notify the National Securities Market Commission (CNMV) of shares and stock options received by directors and managers, and of any amendments, stating the value of the shares concerned. Such notification was to be subject to the rules on the publication of relevant facts laid down in Securities Market Law 24/1998.

Royal Decree 1370/2000 of 19 July 2000 (BOE of 25 July 2000) has recently adapted the regulations existing in this area, contained in Royal Decree 377/1991 of 15 March 1991 on the notification of significant holdings in listed companies and the acquisition by the latter of their own shares (13), to the new notification obligations contained in Law 55/1999. Also, *CNMV Circular 4/2000 of 2 August 2000* (BOE of 15 August 2000) has established the formats for notifications of stock options and systems of compensation of directors and managers of listed companies.

As regards the directors of listed companies, besides the obligations already established, they shall notify stock-exchange managing companies and the CNMV of any stock options they hold at the time they take office. Such notification shall include the options they hold in their own name, through companies they control and through nominees. The same obligation extends to warrants, convertible or exchangeable bonds and any other securities held by them that entitle them to subscribe for or acquire shares. The notification shall be made within seven business days of execution of the contract under which the options are acquired or transferred, and shall specify, inter alia, the number and type of option acquired or transferred, the period for exercising the option, and any financing received for their acquisition. The formats for notification of options and similar rights are contained in Annex 1 to CNMV Circular 4/2000.

The Royal Decree also determines the rules for the notification of systems of compensation of directors and managers. In this respect, both directors and managers shall notify the CNMV, within seven business days, of the granting in their favour of, and of any subsequent changes to, any system of compensation involving the delivery of shares of the company in which they hold office or stock options over the same, or under which payment is linked to the price of such shares. This notification shall be disseminated by the CNMV for the purposes of application of the rules on publication of relevant facts. Annex 2 of CNMV Circular 4/2000 contains the format for notification of such systems of remuneration and of any subsequent change thereto.

Finally, the directors, managers and listed companies to whom any of the circumstances envisaged applied at the time of entry into force of the Royal Decree had two months to comply with the notification obligations therein, which period ended on 14 October 2000.

7. VENTURE-CAPITAL ENTITIES: ACCOUNTING STANDARDS AND FINANCIAL STATEMENT FORMATS

Law 1/1999 of 5 January 1999 (14) established a stable and complete legal framework for venture capital entities *(entidades de capital riesgo,* hereafter, «ECRs») and their management companies *(sociedades gestoras de las ECR,* hereafter, «SGECRs»). This provided a foundation for these entities to continue promoting or fostering small and medium-sized non-financial companies, whose securities are not

(12) See «Regulación financiera: tercer trimestre de 1988», in *Boletín económico,* Banco de España, October 1988, pp. 61 and 62.

(13) See «Regulación financiera: primer trimestre de 1991», in *Boletín económico,* Banco de España, April 1991, pp. 51 and 52.

(14) See «Financial regulation: fourth quarter of 1998», in *Economic bulletin,* Banco de España, January 1999, pp. 100 and 101.

listed on stock exchange main markets, that engage in activities relating to technological innovation or other areas through the acquisition of temporary holdings in their capital. Subsequently, a Ministerial Order of 17 June 1999 authorised the CNMV to issue provisions on the procedure for authorisation of new entities and to establish the accounting standards and formats for the annual accounts, in order to adapt them to the long period of maturation of the investments. It also authorised it to determine the content, frequency and scope of the information obligations.

CNMV Circular 5/2000 of 19 September 2000 (BOE of 3 October 2000), on accounting standards and formats for supervisory and public financial statements, has now been published pursuant to this authorisation.

The first part of the circular refers to the accounting standards and financial statement formats both for venture capital funds and companies, indicating the accounting principles, the general valuation criteria, the general criteria for determining their profits/losses, the recording of transactions, and the types of presentation and periods for submitting the accounting and statistical statements to the CNMV.

The second part includes the accounting standards, the financial statements of SGECRs, and the form of their presentation. The accounting standards shall be those contained in the General Chart of Accounts and, in the event that these prove insufficient, those established for ECRs shall be used.

Finally, the formats for the financial statements of ECRs and SGECRs are included in Annexes 1 and 2, respectively. Financial statements must be sent to the CNMV with the periodicity specified in the circular. In both cases the statements shall be presented on computer media, in accordance with the technical requirements established by the CNMV. The first information that must be sent shall be that for 31 December 2000.

8. PREVENTION OF MONEY LAUNDERING: REPORTING OBLIGATIONS

Law 19/1993 of 28 December 1993 (15) transposed Directive 91/308/EEC of 10 June 1991 into Spanish law. Its purpose was to prevent and hinder the use of credit and financial institutions for the laundering of funds obtained from drug trafficking, terrorism and organised crime. For this purpose, the law created the *Comisión de Prevención del Blanqueo de Capitales e Infracciones Monetarias* (Commission for the Prevention of Money Laundering and Money Offences, hereinafter «the Commission»), reporting to the Ministry of Economy and Finance, and authorised the government to regulate and form this Commission and to create its administrative bodies: the Commission Secretariat and the Executive Service, which was done by means of its implementing regulations, contained in Royal Decree 925/1995 of 9 June 1995 (16).

Inter alia, the regulations specified the transactions that financial institutions must in all cases report to the Executive Service, on a monthly basis, namely: transactions for the movement of cash, cheques or other bearer instruments issued by credit institutions for an amount of more than ESP 5,000,000 (or the equivalent amount in foreign currency); transactions with residents in territories or countries deemed to be tax havens for an amount of more than ESP 5,000,000 (or the equivalent amount in foreign currency), and any other transaction that the Commission should deem appropriate. It also authorised the Minister of Economy to issue the provisions necessary to implement the provisions of these regulations.

Meanwhile, the Financial Action Task Force on money laundering (FATF), of which Spain is a member, on 22 June 2000, approved a report on countries and territories that are not co-operating in the fight against money laundering, recommending the extension of reporting obligations to include transactions with such countries.

Ministerial Order of 3 August 2000 (BOE of 12 August 2000) has now been published, pursuant to the authorisation of Royal Decree 925/1995, to incorporate the results of the work of the FATF into the Spanish prevention system. This order implements the obligations to report transactions to the Executive Service, and extends them to include transactions with the following countries or territories (jurisdictions): the Philippines, the Marshall Islands, Israel, Niue, Russia and Saint Kitts and Nevis.

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(15) See «Regulación financiera: cuarto trimestre de 1993», in *Boletín económico,* Banco de España, January 1994, pp. 78 and 79.

(16) See «Regulación financiera: segundo trimestre de 1995», in *Boletín económico,* Banco de España, July-August 1995, pp. 107 and 108.